IN THE

Supreme Court of the United States

October Term, A. D. 1935.

Nos. 375 and 376

NETTIE MEYER, ANNA JACOBSON, JACOB MEYERHOFF, JOSEPH MEYERHOFF, JULIUS MEYERHOFF, JOHN C. PANKIN and RAY MANN,

Appellants,

vs.

KENMORE GRANVILLE HOTEL COMPANY, *et al.*

Appellees.

On writ of certiorari to the Circuit Court of Appeals for the Seventh Circuit.

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Appellees.

REPLY BRIEF FOR APPELLANTS.

Preliminary Statement.

At the threshold of this case is the question of jurisdiction of the subject matter, the constitutionality of Section 77B, which was challenged in the petition (pp. 30-33). Appellees' brief failed to discuss this whole subject. A prompt settlement of the constitutionality of this Section will be of great public benefit. It will solve the complicated problems of the numerous reorganizations, which are now taking place in the various Federal districts by which fixed liabilities of mortgage debts are exchanged for "voiceless" stock and junior interests are placed on parity with superior interests under the pretense that such is the "spirit of 77B."

We urge upon this Court to squarely pass upon all the questions raised by the petition and not to merely confine itself to the questions raised on matters of procedure on appeal.

The question whether in a reorganization proceeding under Section 77B the District Courts are authorized to exchange bonds for stock, to take away a percentage from the superior interests and to donate it to junior interests, as was done in this case as well as in numerous other cases, is a question of primary importance to the bench and bar as well as to the general public, which is greatly affected thereby. It will serve no useful purpose to merely pass upon the questions of procedure and to transmit the case to the Circuit Court of Appeals to pass upon the merits, for that Court is now committed to the doctrine that under 77B it is not necessary to show any equity in the property on the part of the debtor or the junior interest in order to give them an interest on parity with the bond owners. The spirit of 77B has engulfed many of the Federal District Courts with the idea that it was the intent of Congress to take away a share from the superior interests and to donate such share to junior interests without any evidence as to the value of the property, the feasibility of the reorganization plan, and the nature of the debtor's business. In many instances, as in the case at bar, corporations which were never in business, and whose mere organization was a subterfuge, were allowed to avail themselves of the provisions for corporate reorganizations, which were designed to aid bona fide corporations from their financial distress. This Court has the right to decide all of these questions, even while the subject matter was pending in the Circuit Court of Appeals prior to a decision (28 U. S. C. A. Sec. 347(a), Jud. Code, Sec. 240(a) as amended; *White* v. *Mechanic's et al.*, 269 U. S. 283, 299). *A fortiori* here where the cases were disposed of and the Court has the right to pass upon all questions.

The "Statement of the Case."

Appellants' petition stands as the brief, and appellees' brief is designed to answer the points as they are stated in the petition. The rule of this Court (Rule 27) only permitted "corrections" in the "statement of the case" as stated by appellants, or to point out "inaccuracies" or "omissions." Counsel have not pointed out any inaccuracies or omissions. Their "Statement of the Case" comprising seventeen pages, is far from being "concise," even if such were necessary.

The "Statement" contains "facts" which are not justified by the record. It refers (p. 6) to the record (R. 125, 160) for the "fact" that S. W. Straus & Co. advanced $322,441.25, and that the Nomis-Suarts Corporation (an affiliate of S. W. Straus & Co.) advanced $73,371.45. The references are to the self-serving declaration of the appellees (R. 125) and to the statement of their counsel (R. 160), without any proof to support such facts.

It is also stated as a "fact" (p. 7) that the indebtedness of the two bond issues was "assumed" by the debtor. This statement, evidently of *great importance* in order to convince this Court that there was a "debtor" and "creditor," is claimed to be supported by the record (pp. 123, 160). The first reference is to the agreement between the alleged "debtor" and the "committee" *made February 26, 1935,* one day *after* appellant, Meyer, filed her petition (R. 37), wherein she asserted (R. 64) that there was no debtor and no creditor to confer jurisdiction. Certainly this subsequent agreement to supply the "debtor" and "creditor" or to create such parties did not supply the jurisdictional requirements of debtor and creditor to initiate the proceedings. The second reference is to the statement

of counsel (R. 160) without any proof, and was evidently based on the foregoing agreement. The statement (p. 7) that possession was delivered to the trustees under the first mortgages and "the income applied for the benefit of the first mortgage bondholders" is also claimed to be sustained by the record (R. 22). A mere glance at it will disclose that this was *a self-serving statement of the committee.* The petition of Nettie Meyer clearly shows how the income was used (R. 54). This verified petition must be taken as true in view of the motion to dismiss (R. 88) which operated as a demurrer and admitted the facts well pleaded. Besides, it referred to the decrees, which were entered in the proceedings conducted by the committee, and which show that the trustees were in possession of the premises since 1925, and used the income up to the date of the foreclosure proceedings to reimburse their House for moneys advanced on defaulted bonds and coupons. Thereby the bondholders were led into the belief that the bond issues were in good standing, and were induced to make new investments in similar securities.

The "Statement" refers (p. 7) to the "drastic effect of the depression" during the years 1931 to 1933, but ignores the fact that the bond issues in question were in default in the good years—from 1925 to and including 1929, prior to the date when the real estate market collapsed.

Counsel quote (p. 4) at length from the opinion of the District Judge to the effect that he did not intend to restrain the suit of Nettie Meyer. His intentions are not controlling. *It is his act that counts.* If a reading of the opinion may give an impression that the District Judge did not intend to restrain the action, *the intention is contradicted by his acts in entering the order* (R. 93) whereby he refused to dissolve or even modify the injunction, and which temporary

injunction was made permanent by his final order (R. 157) and restrained Nettie Meyer and any other bond owners from commencing or *prosecuting a suit of any nature* against the trustees or any of them.*

The statement (p. 5), that "Nettie Meyer chose not to participate" in connection with the hearing on the confirmation of the plan, is also contradicted by the record. She filed her petition wherein she assailed the proposed plan of the committee as a fraud, asserted that the conveyance to the debtor was fraudulent, and that there was no debtor nor creditors, and that the Court was without jurisdiction. In their footnote, (p. 4) counsel concede that the Court did not dismiss the petition when it denied its prayer to dismiss the proceeding and to dissolve the injunction, but reserved the petition until the hearing on the plan of reorganization. What was the object in denying the motion to dismiss the petition, but reserve it to the hearing? It was the intent that this petition stand as objections to the plan, and there was no reason or necessity to file any other objections. This petition was not withdrawn, and her counsel appeared and argued the case, and the record shows that it was urged that there was no debtor nor creditor (R. 160).†

The contentions.

In stating appellees' contentions (p. 16) they failed to state their position as to the fairness of the plan, and as to the constitutionality of the Act, both of which matters were raised in the petition (p. 6) and discussed in the argu-

* How the District Court was able to preserve the right of action in the Debtor, who was itself the target to the fraudulent charges, is more than a mystery. It was certainly not reflected in its final order.

† It is true that the objections to the fairness of the plan were filed on behalf of the other bondholders, and not in the name of Nettie Meyer. The reason is apparent. She had her objections on file in the form of the Petition, and the additional objections were filed on behalf of the other bondholders.

ment (pp. 30, 33). Some reference, however, is made in their summary (pp. 26, 27) and in the argument (pp. 54, 55). We therefore, assume that through some error they failed to state among their contentions that they also contend that the plan was fair and equitable, and that the Act is not repugnant to any constitutional provision.

We will, therefore, treat this reply as if such contentions were actually made, and will attempt to reply to the rather confused argument in the chronological order.

I.

The order of March 20, 1935, refusing to dissolve the injunction and to dismiss the proceedings for want of jurisdiction was appealable.

(No. 5491 C.C.A. and No. 375 here.)

Appeal allowable under 24a:

An attempt was made (p. 33) to distinguish the cases relied on by appellants from the instant case on the ground that in the cases cited, the adverse claimant claimed a lien on "specific property," and in the case at bar "all of the property of the Debtor" was in the hands of a receiver, appointed to subject the property to the payment of taxes. The tax receiver was not possessed of the claim, asserted against the two trustees, for malfeasance and misfeasance in office. The receiver was not possessed of the funds which were diverted by the two trustees and turned over to their House during the years they were in possession from 1925 to 1931. Neither the tax receiver nor the Bankruptcy Court had any concern with such claims, which *were for specific property.* Nettie Meyer asserted in the State Court that

the conveyance to the Debtor was a fraud and *claimed adversely to the debtor,* and adversely to the jurisdiction of the District Court. Having asserted such claims on specific property, the Court was without jurisdiction to restrain such proceedings, and she had the right to appeal. Nettie Meyer commenced her proceedings prior to the approval of the 77B proceedings. The jurisdiction of the District Court commenced *from the date of the approval* of the petition under 77B and *not from the date of filing* (*Fox Metropolitan Playhouse,* 74 Fed. (2nd) 722; Sub-section (k) of 77B).

Appeal allowable under 25a:

It was not necessary to rely on 25a to sustain our position as to the right of appeal, but counsel have seen fit to urge that no appeal lies under 25a. We will therefore, reply to this argument.

25a applies to "appeals from judgments adjudicating or refusing to adjudicate a defendant, a bankrupt." Subsection (k) of 77B makes the approval of the petition *effective as an adjudication* in bankruptcy. It specifically says: "The date of the order approving the petition or answer under this section shall be taken to be the *date of adjudication,* and such order shall have the *same consequences and effect as an order of adjudication.*" In the face of this statute how can it be argued that the approval of a petition does not constitute an adjudication for appeal purposes? The intent of Congress was clear, and therefore, it provided no other modes of appeal due to the fact that Sections 24 and 25 of the Bankruptcy Act apply to all amendments thereof. (28 U. S. C. 225c; Jud. Code, Sec. 128.) The word "defendant" used in 25a is substituted by the word "debtor" under 77B. It therefore, follows that 25a governs the

right of appeal from the order approving the petition, which constitutes an adjudication under the act.

The view expressed above was taken by the Circuit Court of Appeals for the Tenth Circuit in *Humphreys* v. *Bankers Mfg. Co.* (Bankruptcy Law Service, par. 3597, August 26, 1935). The holding there is squarely contrary to the decisions rendered by the Seventh and Eighth Circuits and is the more logical.

II.

The appeal from the order refusing to dissolve the injunction and to dismiss the proceedings for want of jurisdiction presented a substantial issue.

Counsel say (p. 41) that they understand our position to be that the allegations contained in the verified petition of Nettie Meyer must be taken as true in connection with the appeal. This is indeed our position. When a matter is heard upon a verified petition upon a motion to dismiss (R. 88) which constitutes a demurrer, and the Court denied its prayer "without hearing evidence," it must be presumed that the allegations, well pleaded therein, were taken as true. (21 Corpus Juris, page 638, sec. 814.) The order in this case (R. 93) recited that the Court denied the prayer of the petition on mere argument and "without any evidence." In view of this, we will not burden this Court with any reply to the contentions that the allegations of the petition were not conceded as true, and were mere "innuendoes."

Appellees started out under the heading to show that there was "no substantial issue" but have *sidetracked* this issue with an argument that there was need for reorganization. It is difficult to reply to such a confused pres-

entation. We will deal with the question of the need for reorganization under the proper heading. As far as the issue under this heading, it is sufficient to say that an appeal which challenges the jurisdiction of the subject matter and which seeks to set aside an injunction does present a "substantial issue."

The contention (p. 44) that these proceedings "in no way hindered the prosecution by Nettie Meyer of any perpetrated cause of action" is contradicted by the acts of the parties and by the record. *They urged the restraining order in opposition to the proceedings in the State Court* (R. 63). The Court refused to dissolve the injunction (R. 93). It was made permanent by the final order (R. 157). How Nettie Meyer could proceed with her lawsuit in the face of the temporary injunction, which was made permanent, is more than a mystery.

III.

The appeal from the final order of confirmation was properly allowed by the District Court.

(Case No. 5531 C. C. A. and No. 376 here.)

It was conceded by counsel (p. 46) that an order confirming a composition in bankruptcy is appealable as a matter of right. They attempted to distinguish between such an order and a final order confirming a plan of reorganization, because in the former, "the debtor has done everything necessary to consummate a composition," while in the latter, the debtor must carry out the order of confirmation in the future, and they referred to the many things to be done under the order, as they have outlined in their brief (pp. 14, 16). The mere fact that counsel have

procured an improper order does not affect the rights of an appeal. The order of confirmation is to be a complete order to the same effect as a confirmation of a composition, and there should be nothing left thereafter to the discretion of the proponents of the plan. The argument that the approval of an order of confirmation amounts to a discharge, while an order of confirmation does not constitute a discharge, is devoid of merit. In a composition the discharge is only from matters included in the composition. The same thing is true on a confirmation of a reorganization plan. This operates as a discharge of all matters embraced by the plan. Sub-section (o) of 77B provides that the rights and liabilities of creditors and of all persons "shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition or answer was approved." Sub-section (g) of the Act provides that upon the confirmation of a reorganization plan the order of confirmation "shall be binding upon (1) the debtor, (2) all stockholders thereof, including those who have not, as well as those who have, accepted it, and (3) all creditors, secured or unsecured, whether or not affected by the plan, and whether or not their claims shall have been filed, and, if filed, whether or not approved, including creditors who have not, as well as those who have accepted it." It is evident therefrom that the approval of the confirmation operates as a discharge to the same effect as the confirmation of a composition. Counsel cite numerous decisions from several Circuit Courts of Appeal, which express the contrary view. We concede that they so hold, but in none of the cases was it pointed out that an order confirming a plan of reorganization is in legal effect the same as an order confirming a composition, which operates as a discharge and is appealable as a matter of right.

IV.

All of the appellants have a right to be heard on the appeal from the confirmation of the plan of reorganization.

The contention (p. 47) that only Nettie Meyer appealed from the order of confirmation is without merit. The petition for leave to appeal (R. 166) was by Nettie Meyer "in her own behalf and on behalf of all other objectors represented by Shulman, Shulman and Abrams." All other objectors who were represented by the same counsel (R. 141-143) were included in the petition, which was signed by counsel. The assignment of errors was by "Nettie Meyer together with all other objectors represented by Shulman, Shulman and Abrams, as they appear of record" (R. 166). *The order allowing the appeal* (R. 168) was "leave to appeal from the entry of the order approving the plan," and "*for the use and benefit of the other objectors.*" No appeal bond was filed but the bond for costs given on the first appeal was allowed to stand as the cost bond on the new appeal. There is certainly no merit in the point that the appeal bond was merely executed by Nettie Meyer. Even if a new appeal bond were given, it is of no concern to the appellees, for they can only recover the costs but once, and if they were dissatisfied with the form of the petition, order or bond, it was their duty to object below and not to raise it for the first time on appeal.

While they undertook to show under this point that the other appellants did not join in the appeal, they also seek to dispose of the appeal of Nettie Meyer. Of course, they could not say that she did not prosecute the appeal, so they ask (p. 48) "What complaint can Nettie Meyer make of the Order confirming the plan of reorganization?" And they

answer, "She made no objection to the plan." Our answer is that *her petition, stood as the objections to the whole proceeding,* and to the plan, by the order of the Court (R. 93). She was a party to the record, and her counsel urged her objection that there was no debtor nor creditor upon the hearing on the confirmation of the plan.

V.

The dismissal of the appeals allowed below and the denial of the petitions to permit an appeal above was an abuse of discretion.

In an attempt to justify the action of the reviewing Court in dismissing the appeals allowed by the District Court, and in refusing to allow appeals by the reviewing Court, they speak (p. 49) of "the attitude of the Circuit Court of Appeals for the Seventh Circuit" as it is revealed from the decision in another case (*Re: Sterba,* 74 Fed. (2nd) 413). The functions stated in the quoted portion of the opinion (p 552), that "it (the District Court) must act as the head of the Administrative Branch of an enterprise" and that "it must originate, if necessary, and in many instances use all forces at its command to bring about co-operation of conflicting interests" are certainly not functions of a judiciary. It was not the intent of Congress to change the administration of justice to "Administrative branches of enterprises" or that of reorganization bureaus—vassels in the hands of reorganization committees, and certainly not as *originators* of compromises of conflicting interests. If such were its functions, then it was indeed in controversion of our constitutional form of government. If the District Court be vested with such duties and functions, and if it also be true that their orders are not appealable as a matter

of right, then it would indeed be an end to all the sacred principles of property rights, and the safeguards of due process of law. If the "originators" of reorganization plans could complete their plans and the facts could in no way be reviewed, how could anyone be safe from the arbitrary acts of a District Court if it so chose to act. The attitude of the Circuit Court of Appeals of this Circuit was also expressed in this case. (See Appendix to Respondent's Brief in answer to the Petition). There, the reviewing Court stated its reasons in no uncertain terms. It dismissed the appeals taken below, and refused to allow appeals because (a) of the small investment of Nettie Meyer; (b) on the technical point that the other appellants did not sign the petition in person; (c) that the appellants were delaying a reorganization, and (d) that some of the appellants spoke through their counsel. The Court there said: "It is significant that the petitioner (Nettie Meyer) did not object to the plan." The plan, which was submitted by the committee, was the same plan which was assailed in her petition (R. 55) as a fraudulent plan, and made with the intent of depriving the bondholders of the value of their securities and "to relegate the bondholders to the position of stockholders." This petition was not dismissed, but was considered by the Court in connection with the confirmation of the plan. The objections urged in her petition were argued by her counsel (R. 141). In the face of this record we are unable to understand the statement that "it is significant that the petitioner did not object to the plan."

When the technical point was raised in the reviewing Court that the appeal taken by Nettie Meyer in her own behalf and on behalf of the other objectors was improper, it was sought to amend this technical defect by a petition in the name of all the objectors signed and *verified by their*

counsel. In denying the prayer for the appeal the reviewing Court said: "Let the others speak for themselves." Since when are parties not allowed to speak through their counsel? Does 77B also deprive them of such rights?

VI.

The reorganization plan was unfair and inequitable and the Court acted without jurisdiction.

Neither under their "contentions" nor under any heading under the various points did counsel indicate that they intended to argue the merits of the reorganization plan. They have done so however, in an indirect way under some of the points, and we will therefore reply to the indirect argument.

The merits of the plan were discussed in our petition (p. 32). We pointed out that the Court was without power or jurisdiction to take away 10% of the superior interests and to donate it to the junior interests. An attempt is made to justify such action (pp. 53, 54) under the theory that 77B was passed "not to extinguish the claims of junior interests." It is one thing not to *extinguish* a junior interest, and another thing to *deprive a superior interest* of a part of his securities and to *donate* it to a junior interest, or to give him a greater interest than he had. This is what was done in the instant case. *The District Court arbitrarily took away 10% from the bondholders and donated it to the junior interests.*

Counsel rely on the decision of this Court in a railroad case. (*Kansas City Terminal* v. *Central Union,* 271 U. S., 445, 454.) It was already pointed out by this Court (*First National Bank* v. *Flersheim,* 290 U. S. 504) that railroad

cases are distinguishable from other cases because in public utility matters the *benefit of the public* is to be taken into consideration, while in the other cases *only private interests exist.* However, even in the case relied on, the Court did not sanction the taking away of superior interests and its donation to the junior interests. The theory of the Court there was based on the fact that *new capital was invested.*

The *Kansas* case (271 U. S. 476) relied on by appellees, in support of their contention that a Court may approve a plan placing junior interests in the same position as superior interests, is squarely against such contention. In discussing the general principles of giving subordinated interests a share in the reorganized property, it there said (p. 454):

> "And *any arrangement* of the parties *by which the subordinate* rights and interests of the stockholders *are attempted to be secured at the expense of the prior rights* of either class of creditors *comes within judicial denunciation.*" *Louisville Trust Co.* v. *Louisville Railway Co.*, pp. 683, 684.

It further said (p. 455):

> "Unsecured creditors of insolvent corporations are entitled to the benefit of the values which remain after lien holders are satisfied, whether this is present or prospective, for dividends or only for purposes of control."

In disposing of the question whether "precedence to the entire claim of the creditor" must be given, it said (p. 455):

> "As above stated, to the extent of their debts creditors are entitled to priority over stockholders against all the property of an insolvent corporation. But it does not follow that in every reorganization the securities offered to general creditors must be superior in rank or grade to any which stockholders may obtain. *It is not impossible to accord to the creditor his su-*

perior rights in other ways. Generally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them unless stockholders are permitted *to contribute and retain an interest sufficiently valuable* to move them. In such or similar cases the chancellor may exercise an informed discretion concerning the practical adjustment of the several rights." (Italics ours.)

It will thus be seen that the only time when a junior interest may receive an interest affecting the rights of superior interests is when "additional funds" are supplied or when the junior interests "contribute" a "sufficiently valuable" share to justify the equalization of the interest thus obtained. Here, no new capital was invested; nothing additional was contributed.

What was the basis of the allowance of the 10% in this case to the junior interests? If a court may take away 10%, it may equally take away 90%, and donate it to the junior interests. If it also be true that no appeal lies on matters of fact, what a great abuse was vested on an administrative "court," or rather, reorganization bureau. Counsel say (p. 54) that the fairness and feasibility of a plan of reorganization is essentially a question for the practical judgment of the trial court. This judgment should not be an arbitrary one. It must be based on proper evidence in the case. A showing must be made as to the value of the property and the equities based upon proper appraisals. (*First National Bank* v. *Flersheim, supra.*) This case is predicated upon the mere statement of counsel (R. 159, 160) and even such statement did not state the basis for the 10% donation. This 10% was taken away from appellants as well as from all other bond owners without any evidence and without any foundation, and with no basis for the order. It was certainly not due process of law.

The Court approved a plan which changed the fixed obligations on the two bond issues to that of holders of beneficial certificates in a trust, and the junior interests became partners to the extent of 10%. We searched appellee's brief for a justification for such action, but were unable to find same. The right taken away from the bondholders to collect on their bonds, to use the full mortgaged property to satisfy the debt, is a property right which cannot be taken away even by a Bankruptcy Court, which must also yield to the Fifth Amendment of our Constitution as held by this Court in the *Redford* case cited in our petition.

This property right, which was taken away, is more significant due to the fact that under the decree on the bond issue placed on the "Hotel," a sale at any time after May 10, 1933, *deprived all equities of redemption* under the peculiar Illinois law as to trust deeds made between 1917 and 1921. (See Petition p. 28). The bondholders of that issue had a vested right by the decree. *Of this right they were deprived in these proceedings without due process of law* (*Stewart* v. *Keyes*, 295 U. S. 403, 417).*

The decree of the State Court, which fixed the liability of the mortgagor under the bond issue on the "Hotel" which was entered in the year 1931 under the statute of Illinois affecting bond issues made during the years 1917 to 1921, *deprived the mortgagor from any redemption fifteen months from the date of the decree,* as distinguished from the decree on the annex, where *the right of redemption still existed* from the date of the sale. On one bond issue the right of redemption had expired. On the other bond issue the right of redemption is still in existence. The com-

* A very interesting case involving the interference of Federal Courts with vested rights of mortgagees under the Illinois statute was just recently rendered by the United States District Court for the Southern District of Illinois, and is reported in the Bankruptcy Law Service, par. 3658, p. 1691, which opinion is illuminating on this subject.

mingling of the two properties under one plan, which deprived the bond owners of the "hotel" property to the extent of 10% of their investment, was unwarranted. It deprived them of their property without due process of law, and the District Court failed to give full faith and credit to the State Court decree, which gave the bondholders a vested right. (*Broderick* v. *Rosner*, 294 U. S. 629, 645.) If there be some justification for giving 10% to the junior interest on the "Annex" bond issue in lieu of their equity of redemption, there is certainly no reason to give them 10% on the "hotel" property, *where the equity of redemption had expired.* The only justification for this *gift* is the statement of counsel (p. 54) that the purpose of 77B was to give "an equitable modicum of participation to the holders of junior claims who co-operate in the reorganization, *a participation offsetting their rights of redemption.*" Assuming that this was the purpose, which we deny, what is the justification for the taking away of 10% on the "hotel," when no equity of redemption existed? If a sale were made under that decree, the purchaser would have received a deed of conveyance with no right of redemption. There is nothing that the junior interests could have done except to bid at the sale and pay the full amount that is due.

We take issue with counsel on the purpose of the Act. It was not its purpose to make gifts or to create a forum for bargains and compromises between superior and junior interests to be staged in the District Courts. The purpose of the Act was to come to the aid and rescue of *bona fide corporate bodies,* who were financially in distress, and *had capital to save above the indebtedness.* It was not enacted for the purpose of *creating* corporations or to *resurrect those who were deceased.* Here were two corporations which were created to execute bond issues enabling the house of issue to float the bonds in the market and to make

profits, and to thereafter disappear. The two bond issues were in default since 1925, and the two trustees, officers of the house of issue, were in possession because of the defaults, but such facts were concealed from the investors in order to encourage them to keep the gold bonds and to purchase new ones. The corporations, who were primarily liable on the bonds, were allowed to be dissolved, and the house of issue obtained title by a junior foreclosure, and its *Trustees used the income to reimburse it for moneys invested in defaulted bonds and coupons.* To conceal the fact that the house of issue was the owner, a new corporation was organized (the Debtor), but *this Debtor was never in possession, was never in business,* and was a mere paper organization for ulterior motives. The house, which secretly owned the property, failed to pay the taxes, using the income for its defaulted bonds, and had its officers, the two trustees, foreclose the whole issue because of alleged defaults of the mortgagors, which have long ago ceased to exist. It acquired two decrees in favor of its trustees and organized a committee, originally of its own officers, and to this date one of its vice-presidents, Sidney H. Kahn, is a member of the committee, ostensibly protecting the bond owners, but in reality, protecting his own interest. It would be strange to hold that Congress had in mind such corporate reorganizations.

No new capital was invested by the proponents of the plan. Instead of proceeding with the foreclosure and distributing the proceeds among the bondholders, a new plan was adopted, which exchanges the interest of the bond owners for stock in a corporation controlled by trustees. How will the bondholders ever get anything for their investments? We think that if the Circuit Court of Appeals would have applied its reasoning of the recent case it decided (*Oak Park Trust & Savings Bank* v. *Lyda Glen Van*

Doren, Nov., 1935, not yet reported) under Section 74 to Section 77B, the results would be different. There it said:

> "It was never intended that Section 74 would afford the relief by extension to those Debtors so hopelessly involved as to hold no reasonable expectation of ability to pay in the reasonable near future. For such Debtors an extension is only a postponement of the day when general bankruptcy is to engulf them and affords no genuine beneficial result either to them or to their creditors."

In that case the Court referred to the Statute on Compositions and held that no extension under 74 should be entertained when the debtor does not contribute in cash the cost of administration, and the discharge of the tax liens. 77B is but one of the forms of composition, and the principle announced to 74 also applies to it. Here the debtor was allowed to obtain the approval of a plan by which no contribution was made towards the payment of the cost or to the discharge of the tax liens. A tax receiver was in possession when the petition was filed. The sum of $129,669.70 is still due for the balance of the taxes for the years 1929, 1930, 1931, 1932, 1933 and 1934 (R. 69). The order of confirmation reserved jurisdiction to tax the fees as costs superior to that of the bond owners (R. 156).* If a property could not even pay the taxes, when no interest was paid to the bond owners since the entry of the decree in 1931, how can bond owners expect to realize anything for their investment under the new reorganization? It will take years before they will see a sign of a dividend.

It was not our purpose in objecting to the plan to interfere with a bona fide reorganization. The reviewing Court, which dismissed the appeal of Nettie Meyer, because of its

* Since the allowance of the certiorari here the District Court entered an Order on November 7, 1935, allowing fees, which Order is now the subject matter of another appeal.

conclusion that with a small investment she attempted to block a reorganization of $2,000,000, completely overlooked that we have presented a feasible plan, which would have protected all interests in accordance with their respective holdings. We originally raised a jurisdictional question, and when the District Court overruled us, we appealed and asked the Court to stay the proceedings pending the disposition of the appeal. The Court determined to proceed with a reorganization. On behalf of other bond owners, who were given notice to appear at the hearing on the confirmation of the plan, we presented to the Court in their behalf a proposed plan which gave the first mortgage bondholders Class "A" stock as a superior interest, Class "B" stock to the junior interest as a subordinate interest, and Class "C" stock as an inferior interest to the owner. This would have given each class its proper interest (R. 144). What was there "too complicated" as characterized by the District Court? (R. 164). We believe this plan was "simple as possible." If the purpose of 77B was to save the investment of junior interests, not at the expense of the superior interests, this plan was the only equitable and feasible plan, and may be a guide for future reorganizations if the Act be constitutional.

Under Point VI we discussed in the petition (pp. 19-29) the merits of the controversy, but counsel's brief did not discuss such matters. They evidently could find no answer.

VII.

The constitutionality of Section 77B.

Under Point VII we discussed the constitutionality of Section 77B (pp. 30, 31) and counsel for appellees ignored the whole subject matter. In addition to the authorities

cited in the petition we cite here the case of *Worther Co.* v. *Cavenaugh* (295 U. S. 56) on the point that the change in the remedy, which deprived the bond owners from their vested rights under the trust indenture on the "Hotel" as well as under the decree, is "an unconstitutional impairment of the obligation of contract (U. S. Constitution, Art. 1, Sec. 10)," particularly in view of the provisions of Section 77B, which authorize the payment of fees out of the mortgaged property for the expense of the Debtor (the mortgagor). It is true that in a bankruptcy case the cost of administration may be paid out of the bankrupt's estate. This is not so in a composition where such costs must be paid by the debtor. The taking away from the mortgagee of the proceeds of the security to pay the mortgagor's liabilities is an impairment of the right of contract, and that part of the Section is certainly repugnant to Article 1, Section 10 of our Constitution. The taking away of 10% from superior interests and the donation thereof to junior interests without an appraisal of the property, and without any showing of any equity, and based on a mere arbitrary determination of a committee or a court, deprived the bond owners of their property without due process of law in violation of the constitutional provisions.

In view of the foregoing we submit that the order of the District Court was erroneous, the orders of the Circuit Court of Appeals were improper, and that the orders should be reversed, and a decision be rendered here on all questions presented by the petition.

Respectfully submitted,

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